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Commodity Prices Rock World Markets: Structural Shift or Short Term Adjustments?

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Skyrocketing agricultural commodity prices are worrisome to consumers and policymakers world wide. Protests and food riots have occurred in over 30 countries, and while some importing nations eased tariffs to encourage trade, some exporters limited trade to protect short domestic supplies. As prices continued to rise over the past several months, key rice-growing countries imposed export restrictions leading to even tighter supplies; countries importing rice faced sticker shock, with prices 60% to 70% higher than just a few months ago. In some cases, family food expenditures have risen dramatically.

The World Bank issued an urgent call to rich nations to help stem rising food prices, warning that unrest in poor countries is spreading, and 100 million people risk falling deeper into poverty. United Nations Secretary General Ban Ki-moon has urged nations to seize an “historic opportunity to revitalise agriculture” as a way of tackling the food crisis. The UN Food and Agriculture Organization warned the developed countries that unless they increase yields, eliminate trade barriers, and move food to where it is needed most, a global catastrophe could result.

In the U.S. food inflation is hurting consumers, school lunch programs, and food banks. Domestic grain merchants, facing high transaction costs, are curtailing some types of contracts, leaving farmers to finance the price risk burden directly. Demand for food grains as biofuel feedstocks sparks moral, as well as economic, debate about the consequences. Adverse weather in the Midwest could result in reduced corn yields later this year.

Are these issues symptomatic of a massive change in agricultural commodity markets, or a short-term response to a collision between policy change, short carry-over stocks, and unpredictable weather? The search for causes leads to the rounding up of a variety of suspects, some usual, some unusual: increasing food demand in rapidly growing developing countries, unprecedented demand for oil from

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China and India, subsidized biofuel production, reckless speculation in commodity markets and the weak U.S. dollar are all cited as causal. But there is little solid evidence to indict a single cause. The current situation is a complex one that includes supply and demand changes that began over a decade ago, structural adjustments, short-term phenomena, and perhaps, just plain bad luck.

This series of articles by top U.S. agricultural economists explores what’s been happening and provides some insight to this emerging phenomenon. Several topics are addressed, including grain prices, the changing behavior of grain merchandisers, the potential impacts of changing food demand and grain supplies, and how feed grain prices may affect meat supplies and prices.

In *Farm Commodity Prices: Why the Boom and What Happens Now?* Pat Westhoff identifies a number of supply and demand factors that have contributed to the increase in commodity prices. Some of these supply and demand shifts may be temporary, while others are more likely to persist.

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John Lawrence, James Mintert, John Anderson and David Anderson, in *Feed Grains and Livestock: Impacts on Meat Supplies and Prices*, conclude that the challenge to producers will be to survive the transition from the old equilibrium based on lower grain prices and export driven livestock and poultry production to the new equilibrium with demand for grain also driven in part by energy demand.

The penultimate article, Scott Irwin, Philip Garcia, Darrel Good, and Eugene Kunda's "Convergence of CBOT Futures Contracts," notes that commodity price convergence problems are inconsistent over time and

across markets and are different than, although related to, non-delivery basis performance issues. Commodity price convergence problems are not fully understood at this point, and the authors caution against substantial changes in contract specifications whose unintended consequences could be worse than the remedy, particularly if market conditions change in the near future.

The final article is *Price Risk Management Alternatives for Farmers in the Absence of Forward Contracts with Grain Merchants*. Darrell Mark, B.Wade Brorsen, Kim Anderson, and Rebecca Small address the thorny question of grain farmer alternatives

to the cash forward contracts that risk-shedding commercial buyers are increasingly reluctant to offer. Several solutions exist, each with disadvantages relative to forward contracting grain with merchants or elevator operators, proving, once again, that there is no free lunch in the risky business of production agriculture.

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